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First National City Bank Monthly Letter

Business and Economic Conditions

New York, July, 1955

General Business Conditions

THE nation has just rounded out the best half-year in its business history, and is starting the second half-year not only with production, employment, purchasing power, and consumption at record levels, but also with bullish expectations perhaps more widely spread than at any previous time during the recovery. For a long time many business observers thought the figures turned in by the automobile, steel and housing industries were too good to last, and considered the outlook for the summer and fall months correspondingly dubious. That attitude has not wholly disappeared, and finds some justification in the fact that the speed of the upswing is due to slow down. But the spread of recovery, its continuing vigor even in the lines mentioned, and the general course of developments during June, have swung the balance of opinion the other way.

The automobile labor settlements which made such spectacular news early in the month have had a strong influence upon sentiment. On the one hand, they removed fears of a costly strike in a great industry, with effects extending to suppliers and producers of materials, and they established instead a pattern of gradual seasonal curtailment which is plainly less disruptive. At the same time, the terms of the new wage contracts have promoted inflationary expectations. The supplemental unemployment benefit plans granted by Ford and General Motors add nothing immediately to purchasing power, since the trust funds to be created cannot be drawn upon until June 1, 1956, at the earliest. But they add to labor costs at once. With the wage increases and fringe benefits, they make up a total "package" of approximately 20¢ an hour, or about 10 per cent of current basic wage rates. In varying degree, and over a period of time, other employers will have to grant increases. The higher wage costs will go around the circle. As we go to press it is uncertain whether a steel strike will occur, but in any case steel wages will rise and steel price increases will almost surely follow. Thus costs of materials and parts, as well as of labor, will be increased.

The Wage-Price Spiral

In these circumstances it must be expected that purchasing agents will see reason to add to commitments, and that people generally will think this a good time to buy. Modest wage increases in times of high sales volume and rising productivity do not necessarily push prices up significantly, but increases which outrun possible gains in productivity are another story. There is no precedent for thinking that increases in wage costs as substantial as those now in the making can be absorbed without raising prices.

To be sure, some time must pass before the higher wages move around the circle. The slower the movement proceeds the better, for there will be correspondingly more chance to

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absorb the higher costs through improved productivity. Moreover, there may be many cases in which increases cannot be passed on because competition will not permit and buyers will not pay the price. In such cases the squeeze must fall on margins. For these reasons the arrival of the new round of increases is being received with mixed feelings and varied estimates of its effects. The over-riding consideration, however, is plain. An influence for higher prices of manufactured goods, and hence a stimulus to more liberal forward buying and inventory accumulation, has been set in motion.

Production and Trade Reports Favorable

While these influences have come into play, general business reports also have added to optimism. Industrial production hit a new record in May and may have matched it in June despite wildcat automobile strikes. Employment in May reached a new high for that month and the U.S. Department of Labor foresees "an extension and possible acceleration of current employment gains". Consumer spending in retail stores, after setting all-time records on a seasonally adjusted basis in April and May, apparently continued strong in June. In announcing a sharp rise in spendable income during May, Secretary of Labor Mitchell noted:

> Factory production workers last month received the highest take-home pay — that is, pay after the taxes have been taken out — than at any other time in history. And more important than that, the purchasing power of this all-time high pay was also at record levels . . .
>
> These two factors, record take-home pay for factory workers and stable prices for the goods and services the worker and his family buy, along with increasing job opportunities and declining unemployment, are concrete evidence of the strength of our economy and mean continued prosperity for workers and their families.

Capital expenditures are being stepped up; new plant and equipment purchases in the third quarter are expected to reach an annual rate of $28.8 billion, up one-eighth from the low first quarter and equal to the peak rate in 1953. Following its pact with the UAW, General Motors announced in June that it was spending an additional $500 million on new equipment and plant expansion, while Ford reported plans for several new or enlarged factories under its $625 million, three-year expansion program. New orders for machine tools rose sharply in May, and the Defense Department is requesting stepped up airplane production.

An official forecast of the U.S. Departments of Commerce and Labor anticipates that construction expenditures will total $41.8 billion during 1955, or 11 per cent more than in 1954. This includes year-to-year gains of 19 per cent in private residential building and 12 per cent in industrial, commercial, and public utility construction. This estimate implies a leveling off of residential construction at about the current rate of something above 1,300,000 housing starts a year, but it also implies a further rise in commercial building and in publicly-financed projects.

As offsets to the areas of expansion, little contraction is in sight other than seasonal slackening and vacation shutdowns. In the automobile industry, to be sure, the curtailment may be more than seasonal in extent. Everywhere rates of gain must be expected to slow. Steel production, for example, rose 54 per cent in the first seven months of recovery; strike or no strike, the period of low automobile operations may bring some curtailment. However, the size of unfilled order backlogs and the persistence of demand for steel have surprised those who earlier predicted a drop in operations to 70 or 75 per cent of capacity during the third quarter. It is plain that nothing of the sort is in prospect.

A Turn in Sentiment?

This description implies that the recovery has reached a point from which it might take an unsound and eventually harmful turn, and that private and public economic policies should be reviewed with the object of checking boom tendencies and maintaining the stable prosperity which has been enjoyed up to this time. In one sense the news is too good. The danger is that the elements making for caution may have been weakened as the automobile and steel industries have performed better than expected, while on the other hand inflationary expectations have been promoted.

At the start of 1955 most observers thought it would be a good year, but few expected it to be a record breaker. Nevertheless, in the first quarter the aggregate output of goods and services pushed past the 1953 peak, and in the second quarter it advanced still further. The gross national product for the first quarter was at an annual rate of $370 billion, and the second quarter is tentatively estimated at over $375 billion. Thus, the first half of 1955 probably averaged 5 per cent better than the same period last year and 2½ per cent ahead of the previous record in the first half of 1953.

Meanwhile the cost of living has been steady. The purchasing power of the dollar has held stable within a very narrow range (plus or minus 1 per cent) during the past 2½ years. As Secretary Mitchell indicated in the quotation given above, the gains in gross product, while meas-

ured in dollars, have represented real gains in living standards — in the physical volume of per capita consumption and investment which are the real measure of a nation's well being. Now the question arises whether the economy is to move into a period during which costs and prices will move up at a higher rate than physical output, substituting the illusion of inflation for genuine prosperity.

In similar situations, business men have at times started speculating on the possibility of price increases and have attempted to jump the gun by building inventories. These moves take time to run their course, but eventually they bring on the very evils they attempt to forestall. The chain of anticipatory buying, inventory building, and price increases builds up a price spiral complete with temporary shortages, renewed wage demands, and the inevitable letdown.

This is not to imply that any increase in business inventories would be out of order. On the whole, inventories are lower in relation to sales than at any time in more than four years. The rise from the low point of last October through the end of April (seasonally adjusted) has been only about 1 per cent — largely in retail automobile stocks. It is to be expected that stocks will be brought more into line with increased production. Inventory swings, however, are a major reason for business fluctuations. A large and speculative buildup would be a powerful influence toward erecting a "bubble on top of the boom". If it should develop during the next six months the outlook for 1956 would be weakened accordingly.

Slack Taken Up

Until recently there was sufficient slack in the utilization of manpower, materials, and industrial capacity to argue convincingly against the possibility of inflation. With the return of production and sales to record levels, there is now less leeway. The labor reserve, as measured by unemployment, was down to 2.5 million in early May, or 3.8 per cent of the labor force. The industrial work-week has expanded to an average of 40.7 hours, indicating considerable overtime work. Supplies of most metals are tight. The situation in steel has been referred to. Scarcity of copper, nickel, and aluminum has caused the Government to divert to private industry substantial quantities of these metals originally scheduled for delivery to the national stockpile. Other metals, such as zinc, have already increased in price.

These signs do not mean that the economy has reached the peak of its capacity — far from it. But in many lines a point has been reached at which it is difficult to expand output in answer to an increase in demand. The high level of optimism and the heavy demand for labor and materials tends to lower resistance to wage demands or price increases. The stability of prices for nearly four years should not lull us into believing that price movements will continue to be minor. Now, more than ever, there is need for caution and forbearance.

It may appropriately be added that the responsibility for making sound decisions rests not only on business men but upon labor leaders and public authorities as well. Rivalry of union heads to get the most they can for their members is conspicuous in current negotiations. Few will doubt that Mr. Reuther's successes were an influence in raising the steel workers' demands on the steel companies, or that the precedent set in these two industries will influence demands elsewhere. To the extent that the economy is now subject to fresh inflationary dangers, this is the primary cause.

Public authorities have no responsibilities for labor settlements or wage rates, and should not have. Their primary responsibility is to direct monetary and fiscal policy toward restraint of inflationary tendencies, and to conduct public affairs with an eye to the potential dangers.

SUB for GAW

When business is bad, people worry about shortened hours, pay cuts, and the difficulties of finding jobs. When business is booming, swollen paychecks and bank rolls give them the power to enjoy added luxuries, including the luxury of leaving the job to enforce demands for even more from the employer. Thus, the threat of strike shutdowns has been shadowing an otherwise bright economic outlook in recent months. The expiration of the five-year Ford and General Motors wage contracts a month ago became the natural focal point of interest. The United Auto Workers — CIO, led by Walter Reuther, had been whipped up to fighting pitch to break the united front of employer opposition and get "GAW" — a guarantee of annual wages. The settlement, while accepting the principle that the employers should supplement regular unemployment benefits, was less remarkable for its limited, and manifestly reluctant, concession to GAW demands than for its 20 cents an hour total cost.

The prosperity of the motor car business, and the intense competition between the leaders, were fortuitous factors favoring the union. Neither company wanted to suffer a long and

costly strike to the benefit of its chief rival. The union had accumulated a "war chest", reported at $25,000,000, which apparently was to be applied, on a "divide and conquer" principle, to bring either one of these two industrial giants to terms. Henry Ford II stated that the settlement was "forced upon us by the competitive situation in the industry". Unauthorized "wildcat" strikes attested to the readiness of the men to shut down the plants and join the picket lines or go fishing. With heavy overtime work these past months, the men evidently were emotionally and financially prepared to enjoy some unemployment without pay.

The UAW-CIO elected to force the issue on Ford and then demand the same, or better, terms from General Motors – not to mention other automobile and also farm implement producers covered by UAW-CIO contracts. The new Ford and General Motors contracts, running for three years, embrace a "supplemental unemployment benefit" (SUB) plan which was hailed by union spokesmen as an acceptance of the GAW in principle. Even though the payments would not be guaranteed, would not be annual, and would not take the form of wages, the SUB scheme, as Mr. Ford admitted, is a step "down the path". Mr. Reuther made it plain that he expected to strike closer to the objective when the present contract expires three years hence.

The cost of SUB was a comparatively minor feature of the Ford and General Motors settlements over-all, which included immediate pay increases calculated to average 6.2 cents an hour, similar pay increases during the second and third years of the three-year contract, five cents an hour for SUB, increases in pensions to retired workers, and numerous other "fringe benefits". The total cost of the "package", without counting pay increases promised for the second and third years or adjustments which may be dictated by a more generous cost-of-living formula, was calculated by union spokesmen at about 20 cents an hour.

Ford's "Prosperity Partnership"

That the Ford Motor Company was prepared to share its prosperity with its employees was apparent in its initial offer, announced May 26. The company's "package" embraced, besides pay increases and numerous fringe benefits, an employee savings and stock purchase plan, an interest-free loan ("income stabilization") plan for laid-off workers, and a severance pay plan. This package paralleled an offer General Motors had put before the union on May 17.

Under the savings and stock purchase plan any worker with more than one year's seniority could have elected to invest up to 10 per cent of his pay, half in U.S. Savings bonds and half in Ford Motor stock sold from present holdings of the Ford Foundation. The company would have matched the 5 per cent invested in Ford stock, in effect giving the employee his stock at half price. The loan and severance pay plans were set up on a more generous basis than the subsequently adopted SUB plan and could have gone into effect without delay. The savings and stock purchase plan offered employees a privilege many investors have long cherished—to own Ford stock. Nevertheless, the "Prosperity Partnership" package – for reasons not plainly evident – was condemned by union leaders as "unfair", "unjust", and "phony".

It is worthy of note that Ford and General Motors employees, whose union leaders so often have pictured industrial profits as colossal and exorbitant, passed up so blandly the opportunity to participate in the earnings—and risks—of share ownership in two of the most spectacularly successful American enterprises. How generous, under favoring conditions, the results of such plans can be was brought out by General Robert E. Wood in his testimony March 11 during the Senate Banking and Currency Committee's inquiry into the stock market. General Wood is chairman of the board of trustees of the Sears, Roebuck and Co. savings and profit-sharing pension fund, created in 1916 and built up from 5 per cent pay deductions supplemented by a 5 to 10 per cent share of the company's profits before tax. With the fund invested largely in Sears stock, the 123,800 participating employees with more than a year's seniority now own 26 per cent of the company. Total resources of the fund exceed $600,000.000, despite employee withdrawals of $351,000,000 since 1916, against employee contributions of $191,000,000. After citing an instance of a little Polish girl who started to work "in the old days" for $6 a week, and who now has $121,000 in the fund, General Wood summarized:

> In fact, every employee who has been with us over 30 years gets out, no matter how humble his position, with a minimum capital of $50,000, which may go up to $150,000. In other words, we are making capitalists every year.

The Supplemental Unemployment Benefit

The final Ford contract dropped the savings and stock ownership plan – which could have increased the individual wealth and sense of participation of the worker – and also the loan

and severance pay plans — which could have been a considerable burden to the company. Instead the union took a hazy shadow of GAW in the form of company contributions at the rate of 5 cents an hour to supplemental unemployment benefit trust funds.

Though the union three years hence expects to raise the ante, the paramount fact that emerges from a study of the SUB plan is that it is a very far cry from the UAW-CIO's concept of GAW. The company's responsibility for help to its laid-off employees is strictly limited to 5 cents an hour for every hour for which employees receive pay. These amounts would be paid into trust funds. When the trust funds reach ceiling amounts (calculated by formula from average payroll data) the employer's contributions would be suspended. Based on the recent scale of operations, it was calculated that Ford contributions might run around $15 million a year and that the ceiling for the fund would be $55 million. For General Motors' auto workers it was figured that the cost might run to $40 million a year and the ceiling would be $150 million.

These funds, two or three years hence, would provide layoff benefits supplemental to state unemployment insurance for as long as 26 weeks. The supplemental benefit, up to a flat limit of $25 a week, would be designed to raise a laid-off worker's total unemployment benefits to 65 per cent of his regular weekly after-tax pay for a period of 4 weeks and to 60 per cent for 22 weeks. No benefits would be paid for the first week off the job. No benefits would go to workers with less than one year's seniority. The number of weeks for which benefits could be drawn by eligible workers would depend on the worker's seniority and the size of the fund.

The plan is designed to come into operation in a gradual way over a period of years. No benefits will be paid for the first year, or until June 1, 1956. Benefits would be suspended if the trust fund should fall below 4 per cent of its calculated ceiling amount. They would be paid, but in reduced amounts, when the fund is in a range of 4 to 12 per cent of its calculated ceiling.

The maximum scale and duration of benefits would apply only to employees with credit for fifty-two weeks of employment prior to layoff and then only when the trust fund exceeded specified percentages of its ceiling level. For example, if the trust fund were anywhere in the range of 4 to 39 per cent of its ceiling level all qualified workers would get benefits for varying periods, depending on seniority, but no one would be entitled to the 26-week maximum. The trust fund would have to reach 85 per cent before all qualified workers would be entitled to 26 weeks of benefits. Even under the most favorable conditions this is unlikely to come about before the three-year contract expires.

Laid-off employees would have to be eligible for state unemployment compensation in order to gain benefits. Presumably employees who have been fired, who go on strike, or who unaccountably do not show up for work would not be covered, although defining the borderline of eligibility is not the least of the complications of the machinery.

That the plan will ever go into effect cannot yet be counted a certainty. Since state unemployment systems commonly forbid benefits to people receiving pay from employers, it will be necessary to obtain approval from the States where Ford and General Motors employees are most heavily concentrated.

Questions Raised

The General Motors and Ford settlements have avoided major strikes and the costly losses they impose, not only on the companies and men and the communities where they operate and live, but on suppliers and others without direct interests in the negotiations. This much is clear gain. Moreover, in negotiating the SUB plan, the employers held firm to principles of vital public interest: (1) limited employer liability; (2) a 60 per cent standard of total benefits; and (3) administration under state unemployment insurance rules.

At the same time, when a new dimension is added to wage contracts, in the shape of individual employer responsibility for supplementing unemployment benefits, and leaders of organized labor insist that we are on the road to unemployment compensation for a full year at substantially full pay, it is a good time to pause and check the questions raised, rather than settled, by the new Ford and General Motors contracts.

One first question is whether, as with pensions a few years ago, a landslide movement has set in that may make SUB plans a commonplace in industrial wage contracts. This seems doubtful. Many lines of business offer steady employment to at least the bulk of their forces. Casual labor, left out anyhow, would rather have equivalent additional pay. In construction the scheme is impractical. The movement so far has been spearheaded by Walter Reuther and has been pushed by only a few of the CIO unions.

Many people prefer a bird in hand to one in the bush and would rather do their own financial planning for the varied emergency needs that can arise. Wildcat strikes at Ford and General Motors after the wage settlement suggested that employees were less enthusiastic about the contract than the union leaders and left an impression that better wage increases might have been more acceptable. As another influence retarding the movement, employers stand opposed, cognizant of the abuses to which overgenerous unemployment benefits are prone. Pensions, which many employers set up on their own initiative, were never subject to this same kind and degree of opposition.

Federal-State Unemployment Benefits

As Harlow H. Curtice, president of General Motors, commented on June 13, when the General Motors settlement was announced:

> The supplemental unemployment benefit plan which the UAW-CIO has been granted is exceedingly complicated and will require some time to appraise fully. We still hold earnestly to the belief that the responsibility for such matters as the amount and duration of unemployment compensation benefits rests with the legislatures of the various States.

For covered employees the SUB plan lays an extra tier onto the unemployment benefits provided under the existing federal-state unemployment insurance system, set up in 1935 and financed by payroll taxes levied on employers. The benefit levels, which vary from State to State, lagged in the race with wartime and postwar inflation. The original concept of the benefits was that, up to a maximum of $15 a week, they should be approximately half of regular weekly earnings.

The 1955 Economic Report of the President stated that "weekly benefits should be sufficiently high to provide the basic necessities," and recommended "that the States change their laws so that the great majority of covered workers will be eligible for payments that at least equal half their regular earnings."

The State legislatures have been busy reviewing and, in many cases, increasing their unemployment benefits. The demand of the UAW-CIO for GAW has added pressure to the movement. Michigan, which has stepped out in front in the liberality of its system, recently acted to raise its maximum benefit from $42 to $54 a week. In New York the maximum this year has been raised from $30 to $36.

An adequate federal-state system should need no supplements. The benefits allow for differences in income levels and cost of living among the States and also permit the state agencies to learn from each other's errors. Credits for stabilizing employment – a feature objected to by organized labor – provide incentives to employers to avoid unnecessary layoffs and turnover.

Aside from the hotly controversial questions of the levels and durations of benefits, the SUB idea has some disadvantages from which regular unemployment insurance is exempt. It ties a man to one firm and makes him less agreeable to change and less acceptable to another employer. Thus we have a sacrifice of economic flexibility, unnecessary wastage of manpower.

Administrative Problems

While accepting SUB, the companies rejected schemes of equal union authority in the control of business policies. Ernest Breech, chairman of Ford, stated unequivocally that the plan will not interfere with management's prerogatives.

The united opposition of business men to GAW is based in part on their knowledge that it is too much to expect ordinary mortals to work in a disciplined way when they can get good pay sitting in the armchair at home. Equally it is based on the apparent aspirations of the proponents, through "Joint Boards," to take over industry and run an economy for the benefit of a minority of industrial workers.

CIO spokesmen have been outspokenly critical of the practices of automobile companies in taking on additional workers in peak periods, in stocking up dealers, in adopting new labor-saving techniques, etc., etc. The CIO Annual Convention in 1951 adopted a Resolution calling for the establishment of "Industry Councils", a "National Production Board", and equal union authority in the control of industrial policies.

The UAW-CIO has had little good to say for the efforts of state agencies to eradicate abuses of unemployment benefits. Their "Progress Report on the Guaranteed Annual Wage" eighteen months ago alluded to the state unemployment compensation agencies as "subject to intimidation" directly or indirectly by corporations.

Stabilizing Employment

"The primary goal of a guaranteed annual wage plan", a UAW-CIO pamphlet tells us, "should be to stimulate management to provide steady full-time employment, week by week, the year around." Employers have many incentives to stabilize production and employment volumes and try to do so within the limits of their resources and the predictability of their markets. It seems doubtful that the SUB scheme will make any critical difference. The

cost to the employer is fixed at 5 cents an hour. Should the trust fund ever reach its ceiling, the employer would save this 5 cents an hour and layoffs would penalize him by forcing a resumption of contributions. But this incentive to avoid layoffs, distant anyhow, may never take full effect; the employer is already on notice that the unions will demand higher benefits as the funds build up. Meanwhile, the increased unemployment benefit makes a layoff more attractive to the men and reduces the hazard to the employer that laid-off men will take jobs with other employers.

There is little question but that the plan, like increases in regular unemployment benefits, will tend to add to average unemployment levels. A stated purpose of supplementing benefits, according to the UAW-CIO, is to avoid having people "forced by the needs of their families to take jobs which do not make the best use of their skills, training and abilities".

Nor does it appear likely that SUB will make any real contribution to stability of consumer spending. Certainly the full-scale GAW would underwrite consumer spending but where the money would come from — except Uncle Sam's printing presses — no one has explained. The outgo of an automobile manufacturer is regulated by its income which is controlled by the buyer. The funds accumulating in SUB trust funds are a drop in the bucket to cushion the ebbs in car purchases. If the companies stopped improving models every year, automobile buying and plant payrolls could be levelled out and the citizen could stop being tempted by new models each winter and spring and spend his money for something else. In a world where one product competes with another, and the consumer refuses to predict and stabilize his tastes and preferences, the consumer as a producer has to suffer the consequences of living in a society of wonderful dynamic change.

Who Will Pay?

Few people question that the Ford-General Motors settlements, not to mention the steel wage settlement, will add something to the prices of 1956 model cars. On the other hand, the consumer holds power to resist footing the bill — for SUB and all the rest. In that eventuality layoffs will ensue beyond the usual seasonal dimensions. Over time, continuing improvements in plant and machinery, and concessions in corporate tax rate, can help cover the cost.

One of the practical questions overhanging from the Ford and General Motors settlements is what the UAW-CIO is going to do with its reputed $25,000,000 strike fund. General Motors and Ford are strong enough to stand up against demands which their managements consider to be unreasonable. The same is not true of all of their diminished number of competitors. George Romney, president of the American Motors Corporation, which produces the Nash and Hudson cars, told the Anti-Trust Subcommittee of the Senate Judiciary Committee a month ago that the UAW-CIO in the past has weakened the competitive position of smaller producers by using its superior strength to inflict higher wage scales upon them. It is for the Congress to determine, in its explorations of anti-trust legislation and the conditions of small business, how far mergers and sell-outs are being compelled by the power of unions.

The GAW Goal

The SUB plan accepts the principle that the employers should supplement regular unemployment benefits. The most obvious pitfalls of GAW have been recognized: the limitation of liability protects the consumer from unreasonable burdens and employers from insolvency; the 60 per cent standard, as opposed to the 80 and 100 per cent standards proposed by the union, leaves a worker a genuine incentive to get back on the job; the provisions for administration reject the view that the state unemployment agencies are too tight and the idea that unions should participate in business decisions.

At the same time it must be frankly recognized that the door has been opened to a continuing movement toward GAW, toward full pay for idle men, mounting financial costs, and shrinking inducements to work.

In a pamphlet, "Progress Report on the Guaranteed Annual Wage", the UAW-CIO states that the argument against "adequate" guaranteed wage payments is "based on an insulting conception of workers" and is "illogical in that it assumes that workers should be responsible for finding jobs".

It is rather hard to see where the "insult" lies in crediting people with the intelligence to stay home when they have neither need nor responsibility for going to work.

Giving away money without corrupting the recipient is an ancient moral problem. A productive country can afford generous aids to people in adversity. It cannot afford to undermine the industry of its people, their willingness to seek out and accept jobs waiting to be filled, their provident self reliance and adjustability. Prosperity does not come from well-paid indol-

ence. Money is worthless unless people will work to earn it.

These are things we must never forget as we consider where the trail of GAW leads.

Prosperity on the Instalment Plan

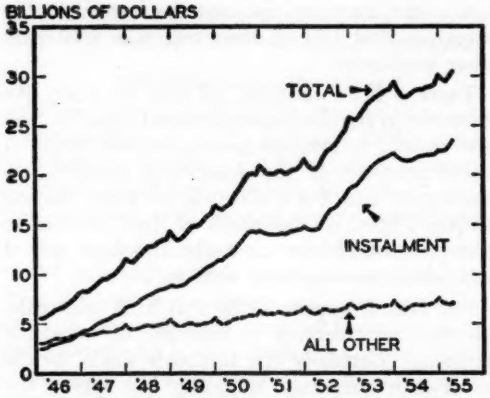
The mounting tide of consumer debt surged to a new all-time high of $31.6 billion at the end of May. Heavy buying of autos and other durable goods boosted the totals in March, April, and May by over $2 billion.

Throughout the postwar period, the willingness of consumers to go into debt to obtain the goods they want has been a feature of our economy. The additional purchasing power provided has been a major factor in developing mass markets for consumer durable goods and promoting the general growth of production and employment. In the process, however, the volume of consumer short-term and intermediate debt has multiplied six-fold. Today, this debt is equivalent, on the average, to more than $625 per family.

This mounting debt has evoked increasing discussion and concern. There is need for a closer look at the figures – the relationship of debt to income and savings, how the debt is distributed, etc.; also at new factors influencing trends in durable goods and consumer financing. Moreover, consumer debt is only one facet of the personal debt problem. Many families who are paying off instalment debt are at the same time meeting payments on mortgages and other obligations.

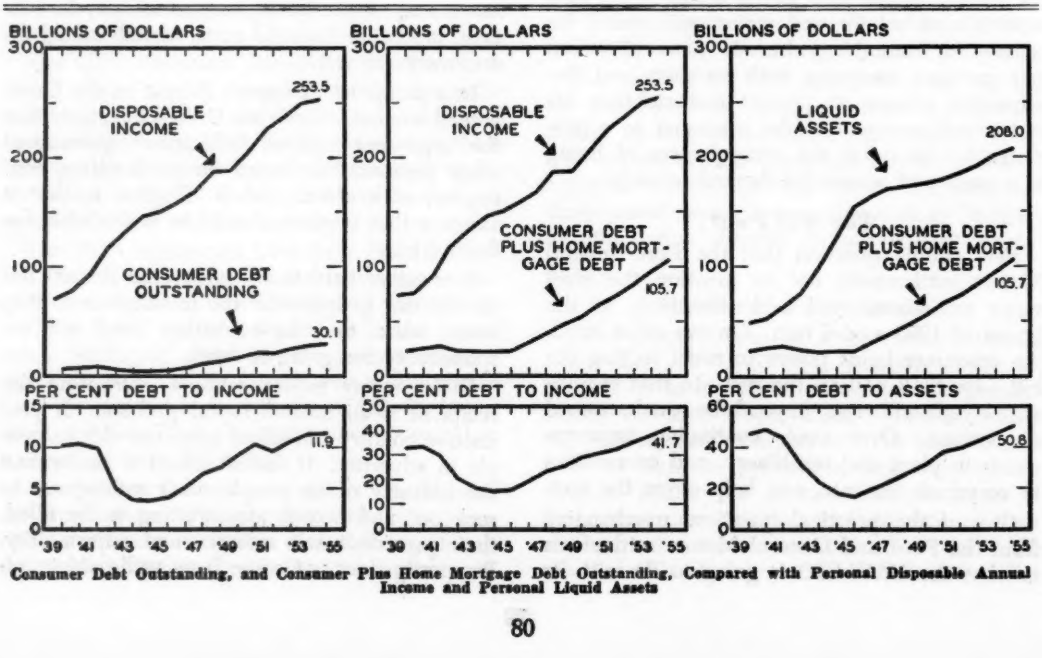
The Over-all Picture

As shown by the chart, the growth in total consumer debt has been mainly in instalment debt – up from $2.1 billion on V-J Day to a record $24.1 billion on May 31. Of the latter, nearly half represented automobile paper, the balance covering other types of consumer durable goods, personal loans, and home repair and modernization credits.



Consumer Debt Outstanding. (Latest figure April.)

While the amounts that people owe have gone up, so too have the incomes they receive and the amounts they have saved – as brought out in the three charts at the foot of the page. These cover not only consumer debt but also home mortgage debt, since the two are commonly linked together in discussions of the so-called personal debt "problem".



Consumer Debt Outstanding, and Consumer Plus Home Mortgage Debt Outstanding, Compared with Personal Disposable Annual Income and Personal Liquid Assets

Here it will be seen that:

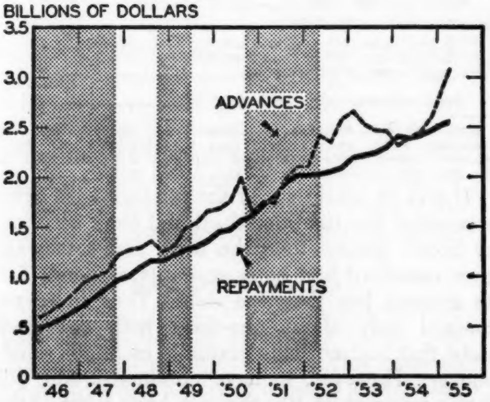
(a) Towering as the present consumer debt, and combined total of consumer plus mortgage debt, appear when looked at alone, they are considerably less formidable when measured against the growth of personal disposable income (what's left after taxes) and readily disposable liquid assets or savings.*

(b) Most of the rise to date in consumer debt and home mortgage debt has appeared merely as "catching up" with the rise of disposable income and savings, after a lag due to World War II controls over credit and materials for consumer goods and housing.

As indicated by the lower panels of the charts, the percentages of consumer debt to disposable income, and of consumer plus mortgage debt to liquid assets, were at the end of 1954 not much more than back to the prewar levels when these percentages were not regarded as dangerously high. While in the case of home mortgage debt, the percentage of disposable income is presently higher than before the war, the actual fixed carrying charge is no higher because of the stretching out of the amortization payments over a longer period of years.

Advances and Repayments

One of the significant things brought out by the next chart of instalment credit advances and repayments is the relative steadiness of the growth of repayments. This reflects both the increase of debt outstanding and the regularity with which the debtors have been making their payments — in good years, and in years not so good such as 1949 and '54.



Instalment Credit Advances and Repayments
(Shaded areas represent periods of instalment credit controls)

The fluctuations have been mainly in the advances, caused partly by changes in consumer credit regulations as in 1948-49 and in 1950-52, and partly by changes in consumer spending-saving propensities as in 1953-54. In the latter period, the consumer borrowed less and concentrated on paying his debts.

Still another feature is the high velocity of turnover in this type of debt. In April borrowers were paying off their instalment debts at the rate of $2.6 billion or 11.1 per cent a month. The volume of instalment debt is not a solid static block upon which new increments are piled, but is a continuously revolving sum, which tends both to safeguard liquidity and maintain general purchasing power. Arthur O. Dietz, president of C.I.T. Financial Corporation, stressed this point recently:

> Ten million American families will complete payments on their automobile instalment purchases in this year alone. This large volume of continuing repayments is sure to help future automobile sales. It also makes an important contribution to the soundness of the instalment credit picture and the stability of our economy at a high level.

Old Yardsticks Questionable

Because of new forces coming into play, a question may be raised as to the reliability under present-day conditions of yardsticks referred to earlier such as ratios of consumer debt to income and savings.

For one thing, mere changes in the accounting of family expenditures affect the debt comparisons over the years. For example, there has been the lessened dependence of many families, even in the middle-income brackets, upon household "help" and greater dependence upon a whole battery of appliances—from dishwashers and laundry equipment to power lawnmowers — to assist in the household duties. Though there was no instalment debt recorded in connection with the former servants, the obligation to pay weekly or monthly wages was a counterpart of the instalment payments on the labor-saving appliances we have today. The charge went on indefinitely. The same parallel can be drawn of monthly payments on the modern mechanical refrigerator versus the old-time iceman, payments on the motor car versus cost of alternative means of transportation, etc. In the case of housing, the growth of home ownership has for many people merely substituted mortgage payments for rent.

Second, the growth of both private and public pension funds, hospital and medical insurance, unemployment compensation, etc., has put people in a better position to borrow and spend for satisfaction of current wants.

Third, and most important, has been the general upgrading in incomes, especially at the

* Currency, demand and time deposits, savings and loan shares, and U.S. government securities.

lower and middle levels, of which there is evidence on every hand. Statistical confirmation appears in various surveys, including those conducted for the Federal Reserve Board by the Survey Research Center of the University of Michigan. According to the latter, based on samplings, the proportion of families or spending units having incomes of $5,000 or more a year has increased since the end of the war from less than 10 per cent to approximately a third, or more than trebled.

To be sure, part of this increase in incomes merely reflects prices, which have about doubled since 1935-36 and are up by one-half since '45. Even so the margin of gain has been very real, particularly in the period of relatively stable living costs since '51.

As real incomes have risen, living standards have improved. More families have moved into income brackets where for the first time they can afford a motor car and a home of their own, and be regarded as worthy applicants for credit. Other families have moved up to where they can afford a better car and a better home, and command the additional credit needed to satisfy these desires. In other words, rising incomes have increased both purchasing power and credit eligibility. As people have been encouraged to reach out for the more expensive types of goods – homes, autos, appliances, etc. – customarily sold on credit, the result has been to broaden these markets, with corresponding increase in the volume of home mortgage and consumer instalment financing required.

Who Are the Debtors?

It is often pointed out that ratios of debt to income and savings are not very meaningful without knowledge as to how the debt is distributed. How proportionately is it distributed over the income scale? To what extent are the debtors and savers the same people, or different people?

Information on the first question is given in the following table based on the Reserve Board surveys referred to above:

Instalment Debt Payments in Relation to Disposable Income, Early 1955

	% of Total	% of Total with Debt
Total Spending Units		
With no instalment debt	57	
With instalment debt	43	
Total spending units	100	
Spending Units with Debt		
Payments 1-9% of income after taxes		35
" 10-19% " " " "		37
" 20-39% " " " "		23
" 40 % or more " " "		5
Total spending units with debt		100

It may surprise many to note that 57 per cent of all families covered in the sampling had no instalment debt at all. These included about three-quarters of the lowest and highest income families.

Of the 43 per cent of all families surveyed that had debt, almost three-quarters had instalment payments equal to less than 20 per cent of disposable income. Only 5 per cent had such payments totaling 40 per cent or more of their incomes, the great majority being in the groups with incomes under $3,000.

On the basis of this study, therefore, it would appear that most families have either no instalment debt, or no more than they can reasonably be expected to carry, assuming no serious shrinkage in incomes. In general, the surveys indicate the bulk of consumer debt to be held by people with good economic prospects. More than three-quarters of it is owed by middle- and upper-income families – particularly those with rising incomes, and by young married couples.

On the second question mentioned above – identity of debtors and savers – the figures available confirm the general impression that many people buy on the instalment plan even though they have liquid assets they might have used. The following table gives the figures for total consumer debt – not merely instalment debt – for families covered in the Reserve Board sample:

Short-term Consumer Debt in Relation to Liquid Asset Holdings, Early 1955

	% of Total	% of Total with Debt
Total Spending Units		
With no consumer debt	44	
With consumer debt	56	
Total spending units	100	
Spending Units with Debt		
With bank accounts or bonds greater than the debt		28
With bank accounts or bonds smaller than the debt		36
No bank accounts or bonds		36
Total spending units with debt		100

Consumer debt includes instalment debt, medical bills, life insurance loans, and personal debt to individuals and other lenders; therefore the percentage with debt is greater than in the first table which covers instalment debt only.

It will be seen that, of the families with debt, somewhat less than one-third had bank accounts or bonds greater than the debt, and somewhat over one-third had bank accounts or bonds but in amount less than the debt. Thus there remained only about one-third with consumer debt that had no bank accounts or bonds whatsoever. However, to have obtained credit this latter group must, like the rest, have satisfied the lender as to earning capacity.

No Pat Answer

Even from the foregoing brief review it is clear that there is no pat answer to the question

whether consumer debt is too high or rising too fast.

Consumer debt — or any kind of debt, for that matter — cannot be viewed as an isolated phenomenon. It has to be looked at in relation to other elements in the economy. With the growth of the country as a whole, expansion of debt is to be expected; the main thing is not the size of the debt but its relation to supporting factors of income, productivity, and savings.

Pessimists stress the magnitude of the present personal debt and the rapidity of its rise. They see widespread evidence of people borrowing to buy, in many cases with little or nothing down and a long time to pay. They ask what is going to happen to many of these debtors if they are thrown out of work and unable to keep up their payments. Bearing in mind the extent to which the national economy has been stimulated by the growth of personal debt, they also ask what will happen to general business if and when the growth of debt slows down.

Optimists base their case on the showing that personal debt, when related to income and savings, is not far out of line with ratios in prewar years when personal debts were not looked upon as dangerously high. They emphasize the growth of population, and the general increase in income and productivity, as warranting a reappraisal of the debt load that people can be expected to carry with safety.

Actually, neither of these points of view can be regarded as conclusive. It is true that there is nothing magical or immutable about prewar debt ratios. Also, on the evidence, there appears a good deal of exaggeration in some of the talk about people being loaded "to the hilt" with debt.

At the same time, it may not be wise to accept the passing of former boundaries of debt relationships as of no consequence. The road may, indeed, be clear for some way ahead; yet we are travelling in uncharted territory and the expansion of debt in recent years at a rate more rapid than the growth of personal income represents a trend that cannot be sustained indefinitely.

The Key Consideration

In this situation, the key consideration may be less the quantity of instalment credit outstanding than its quality. Grounds for concern have appeared in a tendency towards a loosening of credit terms, based on the generally favorable economic outlook, easy money, and competition among lending institutions. Maturity on automobile paper has been stretched out from the traditional 24 months towards 36 months. Down payments in an increasing number of cases have been shaved below the one-third formerly required, openly or through putting an exaggerated value on the car traded in.

Terms for motor car credits longer than 36 months, though cropping up now and then, are exceptional. According to a survey by the American Bankers Association, most banks are sticking to the 24 to 36 months range for new cars with shorter terms for used cars, as are most other big lenders. The danger arises when, under competitive pressures, lenders cooperate with dealers in basing the principal sales appeal on the size of the monthly payment and the discount offered. Unduly liberal terms tempt buyers to over-extend themselves, and may leave them with cars that have depreciated faster than the payments. Thus far the rate of repossessions is almost negligible, but the quality of the credits currently being granted has not yet been fully tested under adverse conditions.

Happily, there appears to be a growing awareness among both lenders and retailers of the dangers of too-easy credit terms. At a meeting in May in Washington, D. C., between representatives of leading auto credit institutions and officials of the National Automobile Dealers Association, concern was expressed over the tendency to relax credit standards. In a bulletin last month the Instalment Credit Commission of the American Bankers Association declared:

> . . . the developments in the instalment credit field during the past several months have caused some apprehension among bank and finance company lenders. This is more particularly reflected in the present conditions and practices involved in the financing of automobile sales. . . . The situation which has developed in the automobile financing field is not sound or healthy for our economy or for banking. Liberal terms may easily encourage the consumer further into debt, perhaps overcoming his initial judgment that in his present circumstances he could not afford the particular purchase.

Similarly, statements by the Secretary of the Treasury, the Chairman of the President's Council of Economic Advisers, the Federal Reserve Bank of Boston, and others have called attention to this problem.

Such warnings parallel others in recent months by leading mortgage lenders regarding excessively easy terms in home financing. In the mortgage field the recent policies of the monetary authorities in taking up slack in the money market and advancing discount rates have had the wholesome effect of making lenders more selective; in the instalment credit field the same influences should have a similar screening effect.

To the extent that the *quality* of any outstanding debt is kept sound, the question of *quantity* will largely take care of itself.

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